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TAGS: [ECON](#) [EIND](#) [ENRG](#) [PREL](#) [RS](#)
SUBJECT: RUSSIA: POWER SHORTAGE OPENING DOORS FOR FOREIGN
COMPANIES

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Classified By: Econ M/C Quanrud. Reasons 1.4 (b) and (d).

¶1. (C) Summary. Above average temperatures this winter have given electricity monopoly RAO UES some breathing room as anticipated power shortages this winter have not materialized, but a booming economy and underinvestment in power infrastructure still threaten to slow economic growth, if not addressed soon. Up to 40 percent of Russia's total power generating capacity (thermal and hydroelectric) needs to be refurbished or replaced. Industry officials admit the only way to meet projected energy demands will be to rely on foreign companies to help build additional thermal power capacity. This an opportune time for a coordinated effort to promote U.S. business in this market segment. End summary.

POWER SHORTAGES CONSTRAINING GROWTH

¶2. (SBU) News stories last year highlighted the growing constraint that power shortages are having on Russian economic growth. In an Indem study conducted last fall, lack of access to power supplies was identified as one of the biggest barriers to opening a business in Moscow. Housing construction, a key component in President Putin's National Priorities, has also been held back by poor access to power: according to Moscow City's head of urban development, the agency will have to reject 70 percent of all development projects planned for 2007 because of power shortfalls. A 2006 UES report estimates that growing energy demand will lead to a 21.5 gigawatt (GW) deficit in the country by 2010 if current generating capacity remains at 205 GW. (Note: Russia's power system, mostly built during the Soviet period, consists primarily of out-dated steam turbines fueled by gas, coal, and fuel oil. Only 20 percent of its power is produced with the more efficient modern gas/steam combined cycle turbines. According to one industry analyst, 40 percent of Russia's total power generating capacity (thermal and hydroelectric) needs to be refurbished or replaced. End note.)

¶3. (SBU) Last winter, Russia's largest power company, Moscow's Mosenergo, struggled to maintain power supplies to industrial consumers. In a December 2006 meeting, Mosenergo First Deputy General Director Dmitry Vasiliev showed emboffs a map of the Moscow region covered with red patches representing new construction and development projects -- projects that will iQreasingly burden the city's

overstretched power infrastructure. Contrary to conventional wisdom, new construction replacing Soviet-era buildings simply demand more power, even though they are more efficient. As an example, he said that Mayor Luzhkov's new modern hotel, in place of the recently demolished Rossiya Hotel, requires 10 times more electricity and each new apartment building replacing a Krushchev-era building draws five times as much electricity. This construction boom will certainly add to the region's four GW deficit.

¶4. (U) These shortages are also starting to affect oil production. UES in December warned oil companies that growing power usage in the Tyumen region could overload the regional power grid and cause large-scale blackouts. According to the press, oil companies are complaining that power shortages are slowing development of the industry. Gazprom Neft last summer had to reduce production by 400,000 tons or one percent of its annual production, when Tyumenenergo shut down one of its plants for two weeks of repairs.

AMBITIOUS INVESTMENT PLANS

¶5. (U) To close the growing power gap, UES has embarked on an ambitious investment program with plans to invest \$81 billion in the next three years to add 20.9 GW of power generating capacity, including 16.5 GW of thermal and 4.4 GW of hydroelectric power. UES's newly restructured Wholesale Generating Companies (WGCs) and Territorial Generating Companies (TGCs) will lead the investment charge. WGC-5, which is furthest along the path to being privatized, is flush with money from a November 2006 public share offering (reftel) and plans to add 1.2 GW of generation capacity in the Moscow, Stavropol, and Yekaterinburg regions. (Note: As

part of UES's reform, the company's generating capacity has been reorganized into six WGCs, 14 TGCs, and a single hydroelectric company. End note.)

¶6. (SBU) Last year, UES accelerated privatization of its daughter companies to attract private investment. After WGC-5's successful share offering in November, UES plans additional share offerings for other daughter companies. In March, WGC-3, will sell a 38 percent stake in a private placement to raise capital for modernization and expansion. WGC-4 and TGC-9 will also turn to the stock market to raise capital later this year. A research analyst at investment house Troika Dialog told us that there was still plenty of demand in the market for additional share offerings. There is active interest among Russian industrialists for power generation assets. For example, Norilsk Nickel acquired 14 percent of WGC-3 in December.

¶7. (SBU) Mosenergo plans to spend \$1.5 billion in 2007 alone and to add two GW of capacity by 2010, according to Vasiliyev. In addition to ambitious plans to overhaul its dated generation capacity with modern efficient turbines and expand capacity at its existing facilities, the utility wants to build an entirely new state-of-the-art regional power facility in southern Moscow, the Petrovskiy GRES-6 (State Regional Power Station - 6).

FOREIGN COMPANIES IN DEMAND

¶8. (SBU) According to industry officials, foreign power generation equipment producers and engineering firms will play a critical role in Russia's ambitious investment drive. On January 11, Mosenergo's Deputy Head of Capital Construction and Procurement, Yuri Dolin, told emboffs that domestic producers are not capable of providing the modern efficient turbines that power companies seek. He added, "your power plants just look much nicer than our power plants." In mid-December, France's Alstom won a bidding contest with General Electric/Iberdrola (Spain) to build a modern 420 MW generating unit at Mosenergo's TPP-26, in the south of Moscow. Dolin also said Mosenergo will open bidding

for the construction of the Petrovskiy GRES-6 in February with active participation from foreign companies.

¶9. (C) Foreign companies also hold an edge over domestic power equipment producers in clean-coal technology. This factor will grow in importance as rising gas prices start making coal-fired power plants more cost effective. Last winter, natural gas shortages for domestic power generation forced the Kremlin to weigh in on the debate over energy strategy. In October, Putin instructed the government to diversify the country's dependence on natural gas and seek alternative fuel sources, namely, nuclear and coal. According to the press, Finnish energy concern Fortum is in talks with TGC-1 in the St. Petersburg region to build a one GW coal-fired power plant. U.S. engineering firm Black and Veatch (Please protect) told emboffs in December that they have a preliminary agreement as the contractor of record to build a coal-fired power plant for WGC-5 in the Yekaterinburg region and have been approached by other WGCs for additional work. They tell us the contract is worth \$400 million.

¶10. (SBU) Other players in Russia's power generation market are strategic investors in the gas, coal, aluminum, and chemical sectors who have been snapping up power generation assets in preparation for liberalization and an eventual rise in electricity tariffs. The head of aluminum magnate Oleg Deripaska's utility unit, Eurosib Power Company, told emboffs in December that he sees foreign engineering companies as "reliable, experienced partners who will build the plant to technical and service level specifications and just give me the key." Many manufacturers are resorting to building their own greenfield power plants to secure an affordable/reliable power supply.

COMMENT

¶11. (SBU) All indications point to a window of opportunity for foreign investors, manufacturers, and service companies in the power generation market. This is evidenced by the active participation of European and Japanese companies. Though lagging behind their competitors, U.S. companies are

entering the market and a few, through local offices, have obtained contracts. We consider this an opportune time for a coordinated effort to promote U.S. business in this market segment. In our conversations, power industry officials openly admit that foreign companies will have to play a key role in UES's ambitious investment strategy.

¶12. (C) Still, there are limits to foreign involvement in the sector. In a December meeting with American Energy Systems (AES) Silk Road, business developer Andrew Favorov (Please protect) told emboffs that the GOR rejected AES' bid to acquire a controlling stake in an Omsk power plant. Whereas decisions for turnkey projects, such as the Alstom and Black and Veatch deals, are made at the company level, deals involving controlling equity stakes in generation assets seem to be bumped up to a political level for approval. Although the GOR does not seem prepared to accept outright foreign ownership stakes in the sector, Fortum and Italy's Enel have managed to keep a low profile with their minority stakes in several WGCs and TGCs. End comment.

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